

Central Intelligence Agency

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DIRECTORATE OF INTELLIGENCE

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**China's Merchant Marine Expansion:
The Impact on International Shipping**

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Summary

China's merchant fleet has grown by one-third over the past five years but, we believe, does not pose a competitive threat to US or other Western shippers at least through the 1980s. Now boasting the world's ninth largest fleet, China services some 600 world ports--including new routes to the United States--and is trying to capture a larger share of non-Chinese cargoes. However, in comparison with other international shipping firms most of China's vessels are old and inefficient and its service is unreliable; moreover, Chinese ports are so congested that many Chinese ships spend long periods awaiting berths instead of carrying cargo.

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We expect little progress in attempts to negotiate a maritime agreement with the United States. While China wants the lower costs and reduced red tape an agreement would offer, Beijing is at the same time reluctant to guarantee US shippers a share of cargoes that would otherwise be carried by Chinese ships. Furthermore, a cargo-sharing

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[redacted]

arrangement could prove irrelevant because China's shallow ports and long turnaround times have kept US and other Western shippers at arm's length, and sufficient improvements to attract them are not likely for many years. [redacted]

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Economic Growth Fuels Merchant Fleet Expansion

China's merchant fleet has grown by one-third over the past five years, trying to keep pace with the growth in Chinese foreign trade¹ and earning much-needed foreign exchange. The fleet, which had only 25 vessels in 1961, is now the ninth largest--in tonnage terms--in the world and second in Asia after Japan (see table 1). The amount of cargo carried by Chinese ships, moreover, increased at a 7-percent annual rate during 1981-84. This growth has come at a time when excess shipping capacity in world trade has driven shipping rates to historic lows and many shipping firms into financial difficulty. [redacted]

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When China began to increase its international trade in the late 1970s, Beijing also started to bolster its merchant fleet, adding domestically built ships as well as new and secondhand vessels purchased in the world market. The Chinese-flag fleet now has a capacity of nearly 17 million deadweight tons (dwt). Of that, China Ocean Shipping Company (COSCO)--China's major state-owned fleet--boasts 614 vessels with about 13 million dwt; provincial and other Chinese shipping firms control an additional 3.5 million dwt (see table 2). Chinese-owned ships that operate under flags of convenience brought Beijing's total ocean shipping capacity to nearly 21 million dwt in early 1986. [redacted]

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China's merchant fleet lags most international fleets technologically--especially because of the many old and inefficient ships added to its inventory during the early days of the buying spree--but Beijing is trying to modernize it. Currently, 35 percent of ships greater than 1,000 gross registered tons are more than 20 years old. General cargo vessels--60 percent of the fleet--are the oldest; 45 percent of them are more than 20 years old. COSCO is now concentrating on acquiring newer vessels and such specialized vessels as containerhips. COSCO's deputy managing director Zhou Dongming in late 1985 said China will focus on the two-to three-year old vessels available at low cost in today's market, and will purchase new ships only when the terms are very favorable. Provincial shipping lines will probably also improve and modernize their fleets, as they move away from being solely coastal operators and expand their services to include Japanese ports. [redacted]

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¹ China's total two-way trade, 90 percent of which is seaborne, has soared during the past three years. We estimate that trade last year exceeded the value of 1984 trade by more than 33 percent, and that 1984 trade was 26 percent higher than trade in 1983. [redacted]

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Table 1 **Million Deadweight Tons**

The World Merchant Fleet

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Rank	Country of Registration	Tonnage	Share of Total (Percent)
1	Liberia	109	17.5
2	Panama	66	10.7
3	Japan	56	9.1
4	Greece	52	8.3
5	United Kingdom	24	3.9
6	USSR	22	3.5
7	US (privately owned)	21	3.3
8	Cyprus	17	2.8
9	China	17	2.8
10	Norway	16	2.5
	Other	221	35.6
	Total	621	

Department of Transportation, Maritime Administration statistics as of 1 April 1986.
 Statistics do not include ships registered elsewhere and operated under flags of convenience.

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Table 2 **Thousand Deadweight Tons**
China's Merchant Fleet, January 1986

Ship Type	Chinese Flag Number	Chinese Flag Capacity	Convenience Flag Number	Convenience Flag Capacity	Total Number	Total Capacity
General Cargo	705	6,881	58	688	763	7,569
Bulk	195	6,131	87	3,344	282	9,475
Tanker	173	2,937	7	166	180	3,103
Container	31	493	2	25	33	518
Roll-on/ Roll-off	10	87	3	11	13	99
Total	1,114	16,529	157	4,234	1,271	20,764

NOTE: All ships less than 1,001 gross register tons and passenger, fishing, research, tugs, offshore oil, and other such vessels--1,252 ships totalling 1,014,627 deadweight tons--have been excluded from the list.

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Expanding Scope: Introducing Competition

Traditionally COSCO's primary function has been the movement of Chinese cargoes on Chinese ships. Worldwide, COSCO has 94 regular ocean shipping routes, including 26 container routes, as well as irregular routes. Beijing has announced publicly that its goal is to carry 70 percent of its oceanborne trade on Chinese registered vessels; COSCO ships now carry about 55 percent, and 15 percent moves on Panamanian or Hong Kong ships at least partly controlled by China. The expansion of other Chinese shipping companies (see the inset) into service to Japan will contribute to meeting Beijing's goal, although these companies will draw cargoes from COSCO as well as from foreign shippers.

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China's Shipping: Decentralization Creates Competition

Until 1984, the Ministry of Foreign Economic Relations and Trade (MOFERT) arranged the shipment of waterborne cargoes, but China's economic reforms permitted traders to make their own shipping arrangements. COSCO had long dominated China's merchant marine, but in recent years other organizations formed or became more active. For example, MOFERT's SINOTRANS (China National Foreign Trade Corporation), originally a freight forwarder, now oversees ship charters, truck fleets, and container freight stations. Similarly, MOFERT's SINOCHART (China National Chartering Corporation) handles cargo in addition to its initial chartering function. Both organizations have established shipping ventures jointly with foreign and local firms. [REDACTED]

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[REDACTED] there are now 73 Chinese ocean shipping companies. Many are administered by regional Bureaus of Maritime Transport (BMT). In the past, the majority of the local and provincial firms operated only in coastal waters and Hong Kong, but many have expanded their services. Sailing mainly to Hong Kong and Japan, BMT and other vessels recently began using new transshipment centers in Kobe and Osaka. China's local businesses are beginning to favor local shipping lines and as a result COSCO is losing some of its valuable long-haul cargo to foreign lines that call at these transshipment centers. [REDACTED]

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Cross-Trades: Reaching for International Cargo

As these smaller shipping companies cut into COSCO's trade, we expect COSCO to try to expand its business through cross-trading. Small amounts of cross-trade cargo were moving along Chinese liner² routes as early as 1981, primarily between Malaysia and Europe. Since then, the addition of specialized vessels--such as containerships--has somewhat improved COSCO's ability to carry cross-trade cargoes. Chinese ships call at more than 600 ports in 150 countries and, since 1984, have expanded services to Japan, Australia, and the United States. In addition, COSCO has established joint operations with firms in Japan, Hong Kong, the Netherlands, West Germany, Kenya, and the United States. [REDACTED]

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² Liner services operate regularly between scheduled ports, charging previously advertised tariff rates. [REDACTED]

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New Services to the United States

COSCO in July 1985 opened liner service between Hong Kong and the west coast of the United States, supplementing longstanding service directly from China. Chinese liner service to the US east coast opened in late 1982. COSCO canvasses for China-US cargo transshipped in Hong Kong; in fact, Chinese maritime officials acknowledge that the new service is an attempt to avoid delays in China's congested ports. The service also competes with other firms for regular Hong Kong-US cargo, but [] is not making money in cross-trading and is probably operated largely as a symbol of China's emergence as a shipping force. [] the Chinese added a Japanese port call to the schedule to make it a profitable cross-trade route. []

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The new service carries mostly Chinese transshipments and very little US-Hong Kong cargo. According to the Port Import-Export Reporting Service (PIERS),³ COSCO vessels carried only 1,133 metric tons of US west coast-Hong Kong cargo on 12 trips between July 1985 and early February 1986. On the east coast route, a single 111-ton shipment was loaded between July 1984 and early February 1986. []

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Chinese bulk and general cargo vessels carrying US cargoes to foreign countries (other than Hong Kong) are doing better than the liner services (see table 3). According to PIERS, China's nonliner vessels carried more than 1 million tons of US cargo to foreign ports between mid-1984 and early February 1986. Although substantially greater volume than the Hong Kong-US liner service, these cargoes accounted for only about 1 percent of all cargoes carried on China's oceangoing vessels. Therefore, they do not represent a significant move into US cross-trade cargoes. []

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Obstacles to Growth

Despite the expansion, several factors will impede China's development as a major cross-trader. A key concern is the excess shipping capacity worldwide. COSCO is attempting to expand its liner services at a time when many carriers are losing money. For example, [] excess container capacity in trans-Pacific trade has forced rates so low that carriers are struggling to meet expenses, and two major carriers--US and West German--have withdrawn from trans-Pacific service. []

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³ PIERS is an on-line data base of shipments to and from US ports. It is operated by the Journal of Commerce, a commercial information service that specializes in shipping and commodity news. []

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China will not be able to provide high-frequency, containerized services to third-country shippers for many years because only 3 percent of its vessels are suitable for containerized liner service.⁴ The remainder of China's fleet, mostly older general cargo and bulk carriers, handles noncontainerized cargoes with little cross-trade potential. [REDACTED]

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Financing additional new ships, moreover, may become a problem because of a lack of foreign exchange--even Chinese shipyards want foreign currency payments for ships, according to press reports. COSCO already pays the full cost of its purchases in foreign exchange. China's regional Bureaus of Maritime Transport are expected to pay half the cost of new ship orders in foreign currency now that their foreign trade activities earn foreign exchange. As a result, we expect other local shipping lines will be expected to pay in foreign currency as their trade volume rises. Because the majority of their earnings have been and will continue to be in Chinese currency from domestic shipping, we expect the foreign currency requirement to inhibit additions to the smaller shipping lines. [REDACTED]

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A Poor Reputation for Reliability

Although China can overcome its lack of suitable vessels through purchases, COSCO also suffers a poor reputation that [REDACTED] limits China's ability to secure cross-trade cargoes. For example, COSCO recently diverted a ship from its US west coast - Hong Kong route to an unscheduled west coast port, leaving a US shipper without expected service. [REDACTED]

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For years, COSCO's main concern was the movement of Chinese cargoes--largely allotted by central government organizations--on Chinese ships. Operating in this noncompetitive atmosphere, COSCO had little reason to develop a reliable shipping organization, let alone marketing expertise. [REDACTED] even after years of experience in Western markets, COSCO vessels not only have trouble keeping a schedule, but the crews fail to see the importance of being on time. In addition, Chinese shipping agents have yet to learn how to market Chinese liner services. [REDACTED]

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In addition, [REDACTED] more US cargoes are being shipped cost-insurance-freight (cif)--whereby the shipper selects the vessel for the China-bound cargo--which will hurt companies with reputations for poor service. Previously, US cif shipments were limited mainly to key bulk cargoes such as forest products, but even in those instances both Chinese timber-buying organizations and US timber sellers have been selecting non-Chinese vessels. Both groups said this practice results from the unreliability of Chinese vessels. [REDACTED]

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⁴ In contrast, 33 percent of the US private fleet is suitable for such service. [REDACTED]

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Table 3

Chinese Movement Of US Commodities In Cross Trades, July 1984 -
Early February 1986

US Exports Carried On Chinese Liner Vessels

<u>Destination</u>	<u>Metric Tons</u>	<u>Commodities</u>
Hong Kong	75,582	Fresh fruit, hides, empty containers, cotton denim, beer, flour, furniture, ink, vehicles, oil, filters, soda ash, diammonium phosphate, telecommunications equipment, and other miscellaneous equipment and machinery

US Exports Carried On Chinese Bulk Carriers

<u>Destination</u>	<u>Metric Tons</u>	<u>Commodities</u>
Belgium	48,718	Petroleum coke
France	73,090	Coal
Italy	65,743	Coal, petroleum coke, wheat, corn
Japan	994,174	Fuel, petroleum products, petroleum coke, coal, corn, soybeans, iron and steel scrap
Mexico	51,826	Coal
Netherlands	50,563	Coal, phosphate rock
Portugal	48,758	Soybeans
Suriname	700	Soybean meal

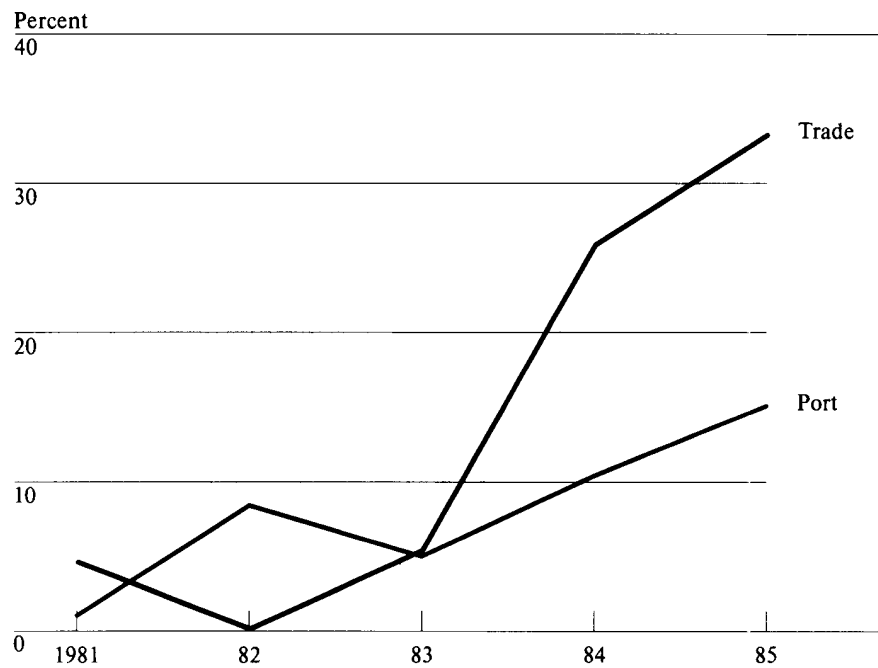
US Imports Carried On Chinese Bulk Carriers

<u>Origin</u>	<u>Metric Tons</u>	<u>Commodities</u>
Canada	67,097	Iron ore
Romania	24,979	Urea
Senegal	0	Empty containers
USSR	24,193	Urea
Venezuela	51,888	Iron ore, San Isidro pellets

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**Port Capacity and Trade Value:
A Comparison of Annual Growth Rates, 1981-85**



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Port Congestion Ties Up Fleets

The long turnaround in Chinese ports is an additional reason for COSCO's failure to increase its share of Chinese and cross-trade cargoes. So successful has China's push been for foreign trade expansion and rapid industrial growth that its coastal and internal transportation facilities have been overwhelmed by record cargo volumes. As a result, more than 500 ships were awaiting berthing space at China's chronically congested ports at various times last year, and major trading partners--headed by Japan--have voiced strong criticism that an average turnaround time of a month or more for ships is simply not viable. [REDACTED]

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Eager not to allow its port congestion problems to stifle progress, China last year mobilized soldiers and military equipment to assist in clearing the ports. In addition, huge quantities of goods, which had been left uncollected at the ports for up to three months, were confiscated and resold by the state when consignees ignored warnings to remove their cargoes from port areas. Chinese port operations and the economy were disrupted despite the emergency measures, however. Steel imports, for example, were virtually halted for months after mid-July 1985 when, according to the official Chinese news agency, 146 steel-carrying ships were queued at six Chinese ports waiting to unload. Similarly, the inability to remove fertilizer imports from port areas brought a temporary halt to China's fertilizer buying on the world market, according to Fertilizer International. [REDACTED]

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China's congested ports adversely affect its own and others' fleets.⁵ Last fall's congestion at Chinese ports tied up shallow draft vessels causing a severe worldwide shortage of ships able to carry grain in the 4,000-to-10,000-dwt range, according to Japan's Shipping and Trade News. [REDACTED]

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Efforts at Improvement

At major ports, China increased freight-handling capacity more than 10 percent in 1984 to 275 million tons. And although capacity exceeded 300 million tons in 1985, expansion was still far outpaced by the growth in trade (see figure). In all, during the Sixth Five-Year Plan (1981-85), China completed 54 deepwater berths, adding 100 million tons of port capacity. However, only 193 of China's 418 berths can handle 10,000-ton-and-above vessels. [REDACTED]

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⁵ In addition to long turnarounds, the shallow draft at many Chinese ports is discouraging to many Western carriers which tend to operate larger ships. For example, China's container fleet averages out at 15,600 dwt compared with 26,200 dwt for US containerships. The average 9,400 dwt of Chinese bulk carriers is even more striking when compared to the US 52,100 dwt average. [REDACTED]

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Congestion Thwarts Trade

Last year proved to be a year of massive congestion at Chinese ports. To illustrate the frustrating times experienced by shippers, the China Daily reported on improving port conditions in late July, noting that the number of ships waiting at China's major ports fell from 540 to 501 in just one week after introducing emergency measures. By fall, however, 500 ships still were awaiting berth space. The Chinese find it difficult to clear the ports when as many as 300 ships arrive per day--about three times the number the ports can handle. According to Chinese statistics, foreign ships spent, on average, 2.4 days longer unloading or loading in 1985 than they did the previous year. [REDACTED]

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Shanghai--China's largest port both in number of berths and cargo handled--was particularly inundated, with 161 ships waiting and storage areas holding 50 percent more than normal, according to the China News Service. Over three years ago, a World Bank study warned that serious congestion problems could occur if Shanghai's cargo-handling capacity failed to keep pace with the anticipated growth in traffic. And fail it did. The number of foreign vessels calling at Shanghai rose rapidly from 2,081 in 1981 to 2,933 in 1985, a 40-percent increase, compared with a 4-percent increase in berthing capacity during the same period. Even though 18 new berths are to be added by 1990, Tu Deming, director of Shanghai Harbor Administration's Planning Department acknowledged that berthing space still may be inadequate and ships still can expect some delays. [REDACTED]

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Last December, while acknowledging the inability of Chinese ports to keep pace with the rapid growth in trade, Huang Zhendong, Vice Minister of Communications, explained that, beginning 1 January 1986, new port fees would be used to add 200 million tons of annual handling capacity by 1990. The Minister of Communications, Qian Yongchang, expects to raise port capacity to 550 million tons by 1990 through the addition of another 100 deepwater berths--most of which are under construction. Nonetheless, in our view, poor management at the ports, a failure to develop an inland support infrastructure, and continuing growth in trade will negate some of these accomplishments. As a result, foreign traders and shippers can look forward to continuing problems. [REDACTED]

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Implications for the United States and Other Shippers

Although Chinese capability for cross-trading is increasing and, in our judgment, will continue to increase, we believe China is at least five years away from becoming a serious competitor to US liner services. China's price advantage, a product of its low-cost crews, has been eroded by fierce competition. More important for the long

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term is the small percentage of container ships in China's fleet and its port congestion and modernization problems. Moreover, these problems may be easier to overcome than COSCO's reputation for poor and unreliable service. As a result, we believe China's merchant marine will continue to carry mostly Chinese cargoes through the rest of the decade. []

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US-China Maritime Agreement

The 1980 US-China maritime agreement, which expired in 1983, was designed to increase bilateral trade by opening ports to each other's merchant shipping--giving each an equal opportunity to participate in the trade generated between the two countries. The Chinese have access to three times as many ports in the United States as US shippers have in China. Port access has not changed in spite of the expiration of the maritime pact. Lack of an agreement, however, complicates scheduling and is more costly to the Chinese, who now must give seven days notice of port calls and pay port tonnage fees of \$1 06 compared with four days and 6 cents under the agreement. US ships were required to give seven days notice for Chinese ports even under the old agreement. But seemingly of greater importance than port notice and tonnage fees is China's desire to avoid the controls of the US-Controlled Carrier Act (Ocean Shipping Act of 1978). This act requires a foreign government-owned or -controlled carrier to maintain just and reasonable classifications, rules, or regulations and to have on file with the US Federal Maritime Commission rates and tariffs that are deemed just and reasonable to obtain the commission's approval for cross-trading. []

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Nonetheless, we expect maritime issues increasingly to be a source of friction in China's relations with other maritime nations. COSCO's aggressive efforts to expand its share of the market are already exacerbating cargo sharing issues with some nations, and the Chinese are taking a hard line in negotiations. The Japanese complained last May about COSCO's inroads into Sino-Japanese trade but were rebuffed. Beijing claimed that it was too early to allocate shares because China was just developing its container fleet. We believe other nations will encounter similar stonewalling as long as China is in a position to expand its market share. []

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For this reason, negotiations on a new US-China maritime agreement will be difficult. The cargo-sharing issue will be a major sticking point, and, in our opinion, China has little real incentive to resolve it. What it stands to gain--somewhat lower costs and less red tape--would come at the cost of a reduced share of Sino-US cargoes (see the inset). In any case, we doubt that US shippers would benefit greatly. China's shallow ports and long turnaround times are obstacles that an agreement cannot remove. And China's refusal to allow foreign shipping agents to establish offices in Beijing makes it difficult to compete for Chinese business. On the plus side--and independent of a maritime agreement--China's economic reforms have given Chinese enterprises greater freedom to use non-COSCO vessels, and US shippers are in a good position to compete for Chinese cargoes transhipped through Japan. []

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